HOW BUSH COULD LOSE • AMERICAN EXPRESS • RECESSION'S LESSONS

NOVEMBER 18, 1991

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FORTUNE

THE MORALE CRISIS

And How to Survive When the Company Is Looking Out for Itself

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NOVEMBER 18, 1991 VOL. 124, NO. 12

FORTUNE

"Loyalty between the corporation and its managers extends only as far as the next paycheck."

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ABOVE: Ray Grassman (left) spent years getting a college degree to ensure his future—then made a career move from Hillenbrand to Reynolds & Reynolds in Dayton. Photo by Rob Kinmonth.

COVER: Watercolor by Marc Rosenthal.

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"In times of stress, communication has to increase exponentially or you won't survive."

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"When I articulate what I'm looking for in my job search, it is much more in terms of how they value their people."

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"I've asked myself if I'm the right guy to do this, and I hate to tell you, I think the answer is yes."

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"More than one day a week in the office, you keep holding meetings, and that screws up everybody else's life."

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"Democrats have managed to cancel out Bush's vulnerability on the economy by their own ineptitude."

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"We don't ride the waves of our markets. We make the waves."

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EDITOR'S DESK

Writer Saporito and American Express Chairman James Robinson

IS ANYBODY up there *listening*? We mean way up there, on the top floor, where all the brass sit. Maybe not.

As evidence, first see our cover story. Writer Anne Fisher describes the gale-force morale crisis in the workplace. But our poll of more than 200 CEOs shows that they think it's a breeze. Then there's American Express, whose management was blindsided by trouble with its Optima card and in the core Travel Related Services division, one of the great profit engines in the history of business till now. Third, there's more bad news from Citicorp. For the second time in a year, America's biggest bank has had to take big hits against earnings.

Carol Loomis

FORTUNE's Bill Saporito started looking into the problems at American Express this summer. That meant he was standing at ground zero when CEO James Robinson dropped the October bombshell that the company was writing off $265 million in bad debts and restructuring charges. Trouble shouldn't have come as such a surprise, believes Saporito, who has chronicled the credit card wars in three major stories in the past 14 months. Says he: "Amex had lost touch with its customers—cardholders and merchants—and didn't know it. The managers were arrogant, something they own up to now."

Business people love to read about success and to learn from triumphs. But there are lessons aplenty in Amex's difficulties, says Julie Connelly, who edited Saporito's story: Stay close to your customer, know what distinguishes you from the competition, and face the facts.

Meanwhile, at Citicorp, Chairman John Reed could use some cheer. Carol Loomis reported its difficulties in a prescient story in January, after Citicorp reduced its dividend, took big special charges, and sang the song that from now on things would be better. Nine months later the company had to announce more special charges and, in a stunning development, elimination of the dividend.

Loomis, who has the most valuable Rolodex in business journalism, spoke with a string of well-placed sources to find out what went wrong—and then landed a timely interview with Reed. Says Loomis: "This company has always revered growth and has never cut costs before. John Reed is absolutely committed to making a U-turn—but what a difficult job it is." To see how difficult, read Loomis's revealing story on page 115.

Marshall Loeb

MANAGING EDITOR

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ment pays U.S. producers hard currency for the poultry. In the 16 months since the buying began, the country has imported some 500 million pounds, about 13% of the total U.S. kill.

So far no reaction from Mrs. Bush. But a spokesperson says, *"Bon appetit."* **– Paul Hofheinz**

Getting a jump on the season in London

EUROPE STARTS CHRISTMAS

■ If you think your local stores are lighting up for Christmas earlier than ever, pity the Europeans. In Britain, workmen in Plymouth were stringing up the holiday lights in 80 degree temperatures in mid-September.

You're already out of luck if you were planning Christmas lunch at London's Ritz Hotel. It's booked. And hurry if you want to sign up for the Ritz's two-night, $1,955-per-couple Christmas package, which includes a trip down the Thames, dancing in the hotel's Palm Court, and Scottish pipers at midnight. The place is running out of rooms. Peter Jones department store in trendy Sloane Square had a tree on display by mid-October.

Britain isn't the only place that's rushing the season. In Paris, for example, the popular Galeries Lafayette rolled out Christmas in its toy department on October 18.

Why so early? "Greed," says Trevor Turner, executive director of London's Bond Street Association. "We're not privileged to have the dividing line of Thanksgiving on this side of the Atlantic."

Others point to the recession. Says Angus Blair, a retailing analyst at Baring Securities in London: "There is no shame in putting up Christmas lights a few months early given the economic climate."

– Carla Rapoport

HOW TO BEAT JAPAN

■ "We will beat the Japanese every time." So says **Bell Atlantic** Chief Executive Raymond W. Smith. That's strong talk from the head of a company that, like the other Baby Bells, is fighting slow growth in its core telephone business and looking for new markets overseas, where Japan competes.

Smith, 54, thinks *all* of U.S. industry will prevail against Japan. His contrarian view: Japan's homogeneous work force, far from being the competitive edge that many proclaim, is an Achilles' heel. By contrast, he says, the diversity of America's labor pool is the key to beating the competition, provided U.S. education improves. Says Smith: "If you take a roomful of Carnegie-Mellon engineers like me, you're going to get a particular slant on solutions. But with a diverse group in terms of race, age, and sex, you'll get a much better array of options."

The Bell Atlantic CEO overestimates his own homogeneity. He writes plays, one of which, *The Fetal Pig*, a comedy, was produced in Philadelphia, Bell Atlantic's home town, in 1987.

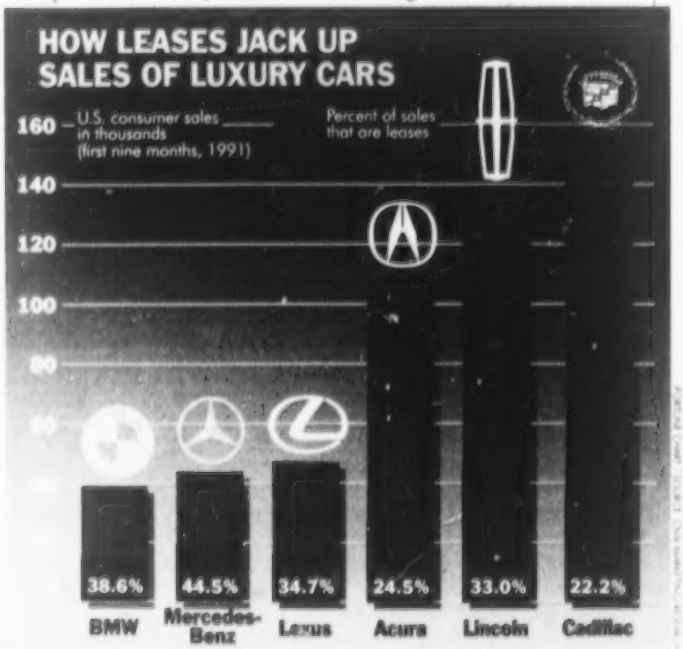
Bell Atlantic CEO Smith: Diversity gives the U.S. a competitive edge.

Japan isn't the Baby Bells' only competitor. The cellular phone business, where real growth potential lies, is a jungle. Bell Atlantic has made a $2.5 billion offer for **Metro Mobile**, a New York City cellular company. But it must contend with a national cellular network just announced by **McCaw Cellular Communications**. Happier news for the Baby Bells: an FCC proposal that they be allowed to carry TV programming to homes. That would put them in competition with cable companies. **– Antony J. Michels**

WILL CAR LEASING BACKFIRE?

■ The Big Three U.S. automakers, which are expected to lose a total of $6 billion this year, are trying to gain customers by pushing leases as an alternative to direct sales. So, too, are foreign competitors (see chart for how this affects sales of some luxury cars, where leasing is most popular).

But the strategy, which sets rates according to how long a customer will use the car and its resale value at the end of the lease, can backfire—hurting not only the automakers but also banks and other lessors. According to Bank Lease Con-



Woodrow Wilson
1919 Peace
Prize: $34,003
In 1991 dollars:
$265,905

Ernest Hemingway
1954 Literature
Prize: $35,135
1991 value:
$295,316

Martin Luther King
1964 Peace
Prize: $52,906
1991 value:
$316,325

Milton Friedman
1976 Economics
Prize: $160,235
1991 value:
$373,881

Robert Solow
1987 Economics
Prize: $341,981
1991 value:
$478,145

Ronald Coase
1991 Economics
Prize: $972,447

THE NOBEL PRIZE'S UPS AND DOWNS

■ When Alfred Nobel established the prize that bears his name, he wanted the award to maintain a consistent value. But after adjusting for Swedish inflation and converting into 1991 dollars, it turns out that until this year, every winner since 1901, when the award was first bestowed, has been stiffed. Of the six laureates shown here, only University of Chicago professor emeritus Ronald Coase, who'll receive nearly $1 million as the recipient of the 1991 prize for economics, gets a purse equivalent to the original award.

By 1953, the value of the prize had dropped 70%. Explains Åke Altéus, deputy executive director of Stockholm's Nobel Foundation: Trustees interpreted Nobel's will to stipulate that the 31.5 million kronor—$196 million in today's dollars—that he left to fund the prize could be invested only in Swedish government bonds. They modified this in 1953 and moved the capital into a broader range of investments. But by 1987 the award was still worth less than half its original value. So the trustees spun off the foundation's commercial real estate holdings into a public company. The stock offering raised almost $100 million. Since then, the fund has increased its prize money by 176%. In the future, the trustees plan to increase the awards to keep pace with inflation.

MIT economist Robert Solow, 67, a winner in 1987, avers that he has no regrets about receiving a prize that earned him $341,981 rather than the $1 million it's worth today. Instead, he bemoans the demands on his time that are brought on by international celebrity. Says he: "People call you up with all sorts of questions. You become a kind of automatic authority on almost everything, and it takes a certain amount of self-control to remember that you really know only a limited number of things." **–R.T.**

sultants of San Leandro, California, resale values for cars leased three to four years ago have dropped up to 18% more than predicted when the leases were drawn up. As a result, says Bank Lease executive VP Randall McCathren, lessors are losing an average $1,300 on each car returned in 1991. He estimates that some luxury imports returned this year are worth $8,000 less than predicted.

Still, manufacturers believe more leasing makes sense in the long run. They're betting that it will expand their customer base and increase customer loyalty. This would ultimately benefit the carmakers when they return to profitability. Meanwhile, low rates and attractive financing are pulling customers in.

Even so, Detroit and foreign automakers are only digging deeper trouble for themselves if resale values don't rebound. Warns McCathren: "Residual values of leases signed this year stand a fifty-fifty chance of being overstated." **–Rick Tetzeli**

MORE PENSION CASH GOES OVERSEAS

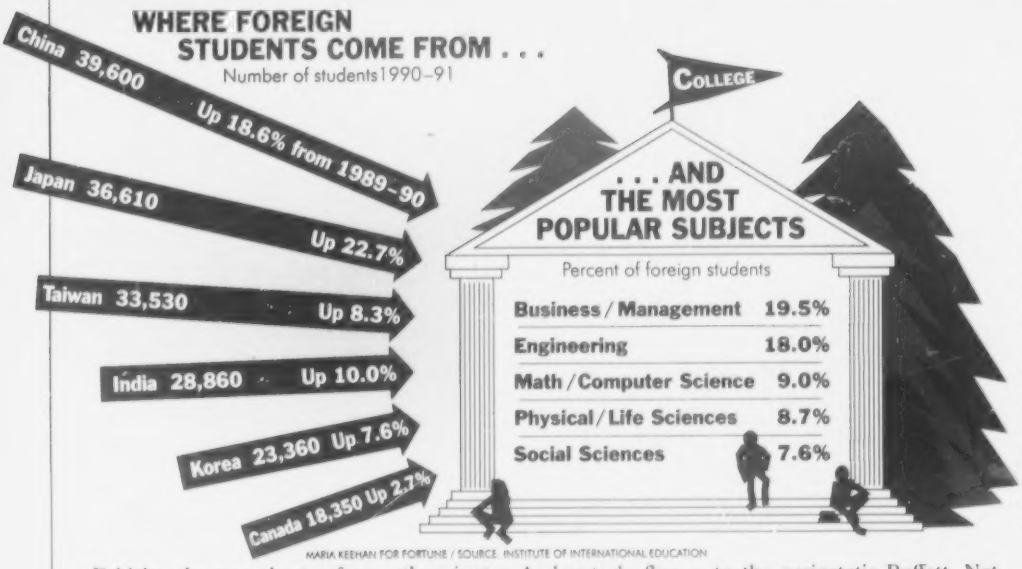
■ Seeking a better bang for their buck, a growing number of U.S. pension fund managers, including those at **GTE**, **IBM**, and **Sears Roebuck**, are putting bigger chunks of the $2.7 trillion in assets they control into foreign stocks and bonds. Greenwich Associates, a Connecticut research firm that tracks how some $1.8 trillion of this money is deployed, estimates that the percentage of corporate and public pensions invested in international stocks will nearly double by 1993. (See chart for how corporations are moving funds.)

Besides the higher returns often available overseas, there is another reason for going abroad. Gunter Ecklebe, senior VP at Frank Russell, a Tacoma asset allocation consultancy, says pension managers want to diversify risk. Foreign markets rarely move in tandem with those in the U.S. There are exceptions, though, including the 1987 Wall Street crash that reverberated at exchanges around the world.

John Carroll, president of the investment management group at GTE, has placed 19% of the company's $12.4 billion pension fund in foreign stocks and bonds, up from 3% in 1984. He aims to increase that proportion to at least 25% within 18 months. Carroll says that although U.S. capital markets have outperformed other world markets in the past two years, pensions must take a long-term approach to investing and focus on economies and markets that are growing faster than America's. Says he: "It's quite pretentious for a U.S. investor to think the U.S. market is going to be the best performing in the world every year for the next 20 years." According to Frank Russell's

A CHANGING MIX FOR PENSION FUNDS

FORTUNE CHART; SOURCE: GREENWICH ASSOCIATES


WHERE FOREIGN STUDENTS COME FROM . . .
Number of students 1990–91
China 39,600 Up 18.6% from 1989–90
Japan 36,610 Up 22.7%
Taiwan 33,530 Up 8.3%
India 28,860 Up 10.0%
Korea 23,360 Up 7.6%
Canada 18,350 Up 2.7%
COLLEGE
. . . AND THE MOST POPULAR SUBJECTS
Percent of foreign students
Business / Management 19.5%
Engineering 18.0%
Math / Computer Science 9.0%
Physical / Life Sciences 8.7%
Social Sciences 7.6%
MARIA KEEHAN FOR FORTUNE / SOURCE: INSTITUTE OF INTERNATIONAL EDUCATION

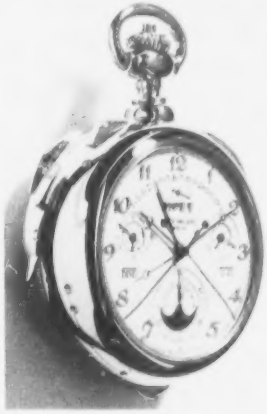
Ecklebe, the annual rate of return from 1986 through 1990 for some 1,000 foreign stocks was 18.7%, vs. 13% for comparable stocks of about 3,000 U.S. companies.

The billions going offshore can deprive U.S. companies that need financing to stay competitive—or in business. But, says Carroll, "I have a fiduciary responsibility to invest the GTE pension fund prudently and legally. Investing in overseas markets is both." **– A.J.M.**

PSSSST! WANNA $5 MILLION WATCH?

■ Switzerland's **Patek Philippe** is hawking the most expensive watch ever made—a $5 million pocket timepiece that took nine years to make. Weighing in at two pounds and finished in rose gold, the so-called Calibre '89 has a 126-jewel movement, a stopwatch, and 24 hands (one of which tracks the date of Easter through the year 2046), among other embellishments. It also has two faces. One is traditional. The other has a moving map of the heavens so the lucky owner can keep sidereal time. Another extra: The owner can set it to chime not only the hours but the minutes. And no tacky fluorescent hands for this turnip.

To give Americans a glimpse of the watch, Patek is taking it to Omaha for an exhibition in April at Borsheim's Jewelers, owned since 1989 by Warren Buffett's **Berkshire Hathaway**. Fellow travelers to the show include various antique timepieces from Patek's private collection. Among them: pocket watches owned by Queen Victoria, Albert Einstein, and Rudyard Kipling. Hank Edelman, VP of Patek's U.S. operations, insists that the goal of the exhibition isn't to sell the watch to the peripatetic Buffett. Not that the billionaire's time isn't becoming ever more squeezed. Besides trying to rescue **Salomon** from scandal and overseeing his investment empire, Buffett recently taped an appearance on ABC's *All My Children*, as a tycoon dispensing business advice. Also guest-starring in the same segment of the soap: Buffett's good buddy Thomas Murphy, chairman of **Capital Cities/ABC**. **– R.T.**



For the retiree who has everything

MORE FOREIGNERS AT U.S. COLLEGES

■ Almost 37,000 Japanese students were enrolled in U.S. colleges and universities during the 1990–91 academic term, a 22.7% increase over the previous year. The total number of foreign students on U.S. campuses rose 5.3% to 407,529 over the same period. (See chart for where some of these students came from.) For the second year in a row, business and management was their No. 1 choice as a subject after engineering's 40-year reign in the top spot.

Who's picking up the tab? At Northwestern's J.L. Kellogg School of Management, where 18%, or 198, of the 1,100 MBA students are foreign, 26 have their $17,800 tuition paid by their employer back home; ten are on Fulbright grants. The rest are responsible for their own fees, since Kellogg provides financial aid only to Americans. Of all 407,529 foreign students in the country, about 65% are paying their own way, 20% get funding from the school they attend, and the other 15% are receiving assistance from other sources, including the U.S. government, which subsidizes about 8,000 of them.

Wouldn't the school scholarships and taxpayer money be better devoted to Americans needing a college education? Yes, says Frank L. Morris, dean of graduate studies at Morgan State University in Baltimore, which has a predominantly black student body. He argues, "We're providing opportunities for foreigners we're not providing for minorities." **– A.J.M.**

NOW HEAR THIS

■ **KENNETH OLSEN,** 65, president of Digital Equipment, translating the microscopic inscription that company engineers inscribed on chips in Digital computers used in the Soviet Union, where manufacturers sometimes rip off imported technology: **"Hi, Comrades. When you care enough to copy the very best."**

■ **DR. RUTH WESTHEIMER,** 63, a sex therapist, to a group of men and women at a Manhattan dinner party, on the Clarence Thomas–Anita Hill sexual harassment imbroglio: **"Unfortunately, it will make men much more timid about flirting around the water cooler."**

LETTERS TO FORTUNE

IN DEFENSE OF LBOs

You make some valuable points in "The Deal Decade: Verdict on the '80s" (August 26), and I hope you and others will persist in completing this research and in drawing distinctions among participants' outcomes. It is important to understand what has worked, what hasn't, and why.

LBOs and hostile takeovers began as a response to poor investment returns. The properly organized LBO involved a stable, mature business that by its nature generated more cash than it used and therefore was properly capitalized with a fair amount of debt. When one hitched this profile to a combination of professional ownership, management ownership, and financial leverage, one could expect better balance sheets and operating cost management.

Because this model worked so well, the firms making up professional ownership groups developed leveraged buyouts as an asset class for institutional investors. And so for the better part of a decade, many of the LBO firms have had to hold themselves to the standards of those institutional investors—standards that previously had not been satisfied by managements and their boards.

Commentators generally have not distinguished between professional investor groups who managed capital, kept their focus on appropriate companies, invested their own capital, and insisted on management capital as well—aligning investor interests—and all those others, ranging from risk arbitragers to raiders to investment banks to corporate managers trying to preserve their independence, who undertook LBOs in the second part of the 1980s largely because the money was available.

I feel we have been tarred with the brush of failure by your article, yet we know we have met the test of providing superior investment returns to insureds and pensioners as well as to ourselves. KKR, Forstmann Little, and others have published their superior returns. So at least in the minds of one small group of people, leveraged buyouts have met the most objective measure of corporate success.

CARL FERENBACH
General Partner
Berkshire Partners
Boston

WHERE DO WE GO FROM HERE?

Your Education Special Report (October 21) should be a regular feature. There are kids going to schools that lack working toilets, kids who think of books that arrive halfway through the school year as Christmas presents, not part of their birthright. There are teachers trying to teach immigrant children and being penalized for speaking in the immigrant language or trying to teach them reading without bilingual aides (who have been lost to budget cutbacks). Thousands of children stay home every day to watch younger siblings so that their working poor parents can go to their jobs.

"Children stay home every day to watch younger siblings so that their working poor parents can go to their jobs."

Kids who can't read grow up unable to vote intelligently. They can't take care of *their* kids because they can't read labels. They can't complete job applications or even read bus schedules to get to a hiring office.

Where *I* go from here: Thanks to your table in "How Business Helps the Schools," I've added another consumer-friendly category to the list of companies whose products I will support as a consumer or otherwise invest in—those with four or more dollar signs for educational support after their names.

CELIA COFFIN MOREY
Volunteer
Board of Directors
Reading Is Fundamental Inc. of Southern California
Los Angeles

I had always assumed that if we threw enough money at it, the quality of education must escalate. Wrong! The chart in "For States: Reform Turns Radical" shows that Iowa is No. 1 in scores and No. 3 in its graduation rate, but 36th in average teacher salary and 28th in average pupil expenditure. Meanwhile, Washington, D.C., is No. 50 in graduation rate and 22nd in scores, while the average teacher salary is an extraordinary No. 3, and expenditure per pupil is No. 1. Quality does not always relate to dollars.

GEORGE ELMSTROM
Carmel-by-the-Sea
California

A CAPITALIST CORPS

Re Ann Reilly Dowd's suggestion that the U.S. build "something like a Capitalist Corps, fashioned after the Peace Corps" ("How to Help the Soviets," October 7): Something similar, run by the Institute for Applied Economics, a public charity in New York City, already exists. It brought several Soviet executives to the U.S. this summer for on-the-job training in major U.S. companies. Plans call for 100 Soviet executives to participate in this program this year and 500 within five years.

JOHN M. CLYMER
Director of Development, the Leadership Institute
Springfield, Virginia

FORM AND FUNCTION

IBM did the PC right ("The Future of the PC," August 26); had it made the personal computer closed and proprietary, it would have met with the same kind of end-run as its proprietary mainframe. In the 1930s, Antoine de Saint-Exupéry said a machine becomes a part of society when it "loses its identity in its function." If IBM doesn't lead in this parade, it will be run over by it.

MYRDDIN L. JONES
Vice President for Marketing, Apris Corp.
Malvern, Pennsylvania

CORRECTIONS

In "For States: Reform Turns Radical" (October 21), the fourth column in a table titled "The Nation's Report Card" was not aligned with the corresponding data. The Pupil/Teacher Ratio rank for each state beginning with Florida and ending with Washington can be found on the following line: Washington, D.C., should be ranked No. 2.

Also, in the 1992 Investor's Guide, through a production error we printed an incomplete version of a table that appeared in "Nailing Down Tax Savings Now." The correct version is printed below. FORTUNE *regrets the errors.* F

WHY THE TAX RATE TOP DOESN'T STOP

TAXABLE INCOME (after deductions and exemptions)	TOP MARGINAL TAX RATE	COMMENT
Up to $34,000	15%	If you're a married couple filing jointly and your taxable income falls into these ranges, calculating your top tax rate is a breeze. If your income before deductions and exemptions is above $100,000, though, the rules change.
$34,001 to $82,150	28%	
$82,151 to $100,000	31%	
TWO CASE STUDIES ABOVE $100,000		
Income before deductions and exemptions: $150,000 Married filing jointly No children	31.93%	You lose 3% of the value of your itemized deductions on income above $100,000. Assume this couple had deductions worth $20,700. The phase-out adds $621 to their taxable income and raises their top rate by nearly a percentage point.
Income before deductions and exemptions: $175,000 Married filing jointly Two children	34.06%	You also lose 2% of the value of personal exemptions on every $2,500 of income above $150,000. Assume this couple had deductions worth $41,400. The 3% phase-out plus the limit on exemptions lifts their top rate by over three percentage points.

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MORALE CRISIS

Job satisfaction among middle managers is hitting new lows. What's an employer to do? ■ *by Anne B. Fisher*

TIME WAS, making it into the managerial ranks used to mean something: a sense of accomplishment, a bit more confidence about the future, greater identification of oneself with one's employer. Not so much anymore. Steadily growing legions of supervisory types, their livelihoods endangered by cost cutting and recession, are angry, distrustful, stressed out, and scared.

Like lieutenants in the army, these are the people who translate the generals' commands, squad by squad, into movement on the ground. But their demoralized state of mind today is not at all conducive to improving productivity or increasing quality—let alone innovating. All too often, the people who used to be the brass's most reliable backers—middle managers, professionals, and other white-collar workers—now seem to feel more disenfranchised and cynical than the hourly folks. And because of their perception that the upper echelon has turned on the underlings, the white-collar blues won't go away anytime soon, economic recovery or no.

Signs abound of how bad things have got-

MIDDLE MANAGERS RATE THEIR COMPANIES

Percent who expressed a favorable attitude on:	1985–87	1988–90
Information given to employees	85%	69%
The ability of top management	54%	38%
The company as a place to work	65%	55%
Companies treating them with respect as individuals	51%	43%
Top management listening to their problems and complaints	42%	35%
Their pay	47%	52%

Based on a survey of 750,000 middle managers by Hay Research for Management

FORTUNE CHARTS

ILLUSTRATION BY MARC ROSENTHAL

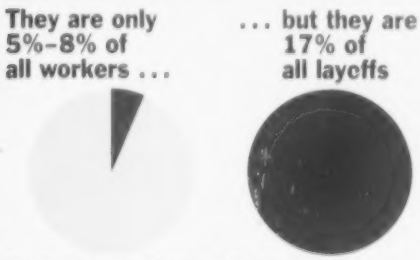
ten around the office. To take just one: The Roper Organization in New York City has been polling some 1,200 employees every few years for a couple of decades. Today the firm finds job satisfaction in America at its lowest ebb since it began its surveys. This recession differs from previous ones, says Bradford Fay, a Roper researcher, in that middle managers now are "screaming." One reason: "Attitudes toward mergers have soured as people see those at the top getting generous pay, perks, and golden parachutes, while everybody else fears getting laid off."

Middle managers have more reason to fear layoffs than do hourly employees. The American Management Association has conducted annual surveys on downsizing among some 1,100 of its member companies and found that while middle managers make up only 5% to 8% of the work force, they account for 17% of all dismissals in the past three years. The research also shows that thousands of companies have downsized more than once since 1988.

With fewer managerial bodies around, those left often end up working harder and longer. Swain & Swain, a consulting outfit in New York City, uses surveys of 200 employees at five FORTUNE 500 companies to study a dozen "coping mechanisms" in corporations. The firm has found that the two most essential are now, unfortunately, the weakest. These are "situation mastery," whereby people feel they can handle what they must do, and "positive outlook"—what most people except psychologists call hope. Both are all but gone. "Everybody is exhausted, and nobody really thinks things are going to get better," says Robert Swain. "They're hanging on by their fingernails."

In seminars, Prudential explains to its managers that now they're responsible for their own careers.

MIDDLE MANAGERS LAID OFF



Based on a survey of some 1,100 companies by the American Management Association

The American Management Association defines middle managers as everyone between first-line supervisors and senior management. After all that restructuring, they think less of the brass, but fewer complain about pay than before.

Many have concluded that restructuring will never stop. Even companies that have already cut thousands of white-collar jobs, like Citicorp, Digital Equipment, General Electric, and Eastman Kodak, continue to hack away. And while it's fashionable for the fellows at the top to talk about empowerment, middle managers often feel *less* able to make decisions. Try spending the whole day saying no to the valued people under you—especially "No, we can't try anything that might cost money, including keeping you on here"—for a sense of how isolated, powerless, and thankless the middle manager's job feels now. "Fear is rampant in the workplace," observes Robert J. Kriegel, a consultant and author of a book called *If It Ain't Broke . . . Break It!* Fear, he says, creates a "white-collar sweatshop. It drives stress up and quality down."

IF YOU ARE THE CEO or division head, you may be assuming, or at least devoutly hoping, that the people under you blame the recession, the Japanese, or some other distant, nebulous villain. Think again. Increasingly, they blame you. The Hay Group, a Philadelphia consulting firm whose clients include American Airlines, Disney, GE, Chase Manhattan, Maytag, and other heavy hitters, has over time surveyed 750,000 middle managers in 1,000 big corporations. The firm's research indicates that between 1987 and 1990, the white-collar legions' most common estimation of their bosses' overall abilities has dropped from "generally high" to "frankly, awful."

High-octane CEO salaries and perks have ignited plenty of public indignation, but in middle managers' eyes, money isn't the point. Most say they wouldn't begrudge the big guy his big bucks if he seemed to know what he was doing. The course of restructuring—all the merging, downsizing, and demassifying that has contributed to the elimination of 3.4 million jobs from the payrolls of the FORTUNE 500 industrial companies in the past ten years—has failed to produce the kind of results that might bolster faith in top executives' judgment. This spring the Cresap division of the consulting firm Towers Perrin asked about 350 senior managers in 275 major companies, together accounting for 26% of U.S. gross national product, whether they thought their cost-cutting programs or restructurings had achieved what they had hoped. Half said no.

Another study, by consultant Wyatt Co., found that in 1,005 corporations where restructurings had occurred, most senior executives admitted their companies had missed the mark in one way or another. Fewer than half met their cost-reduction targets, despite much bloodletting. This, they reported, was often because they had cut people without reducing workload, so that pricey outside contractors, and sometimes new full-time hires, had to be called in to take up the slack. Only 32% raised their profits to a level they thought acceptable, and just 21% improved return on investment to any ap-

preciable degree. A full 58% thought that employee morale was battered by the changes, and 37% said they were having trouble persuading survivors to stick around. (The people at the very top, the CEOs, don't seem to have picked up on this, though; see the following story.) A wistful 87% confided that when they offered early-retirement packages as part of restructuring, they lost star performers they counted on keeping.

TOP MANAGEMENT'S next, and perhaps most unexpected, worry is how to prevent valued middle managers from stampeding out the door when they finally see a bit of blue sky in the economic picture. Some experts say that even before the recession has been declared officially over, they detect signs of impending managerial flight from outfits battered by restructuring. "You can cut down to the bone, and most companies have," observes John Hinrichs, president of a Darien, Connecticut, consulting firm called Management Decision Systems. "The question in the next five years is, How are you going to keep the bone?" No reliable statistics exist to show how many people jump ship each year, but executive recruiters report their offices are flooded with résumés of talented middle managers eager to quit their jobs.

"Nine or ten times as many people are coming to me now, compared with a few years ago, saying they want out," observes Dee Soder, president of a New York City consulting and career-counseling firm called Endymion. Soder says her restless clients earn upward of $200,000 a year. More money isn't what they're after. "These are stars. Their bosses want to keep them," she notes. "But they don't trust their bosses."

"You can cut to the bone . . . The question in the next five years is, How are you going to keep the bone?"

Where will itchy managers land? Letitia Chamberlain, director of the Center for Career and Life Planning at New York University, says most of the 1,000 or so white-collar people her counselors see each year say they want to move to smaller companies, where they hope to achieve more control over their careers. As early as 1989, a survey by the National Opinion Research Center found Americans leaning toward self-employment or joining a small shop. Says NORC researcher Tom Smith: "This desire is interesting, when you consider that benefits and pay are generally better in big corporations, and most people know that. But there is a definite antipathy toward bigness."

Some dissatisfied managers are exploring career options that didn't exist ten years ago. Joseph Valenta, 57, a Ph.D. in biochemistry with a degree from Wharton, spent 29 years running various research projects at SmithKline Beckman. When the pharmaceutical biggie merged with the British company Beecham in 1989, Valenta and several others in the upper-middle-management ranks were given a choice: Move to England or take early retirement.

He chose the latter. The experience left him with feelings commonly expressed by middle managers these days. "SmithKline lost many excellent people for the wrong reasons," he says. "It's a sad thing. Loyalty between the corporation and its managers extends only as far as the next paycheck. The top people are riding on the backs of the mid-level people, and they think that's appropriate. But middle managers are waking up now, and things are going to get rocky." He adds, "In my career I gave up a lot of personal plans—anniversary parties, vacations, and so on—for the sake of the company. I wouldn't do that today, because I've realized all the loyalty and sacrifice was going one way only."

Now Valenta is calling his own shots. He's currently on a nine-month management assignment for a small biotech operation, a division of Johnson & Johnson, and loving it. When this stint is over, he'll move on to another temporary job elsewhere.

Thousands of managers around the country are doing the same thing, as the so-called interim-management business picks up steam. Karin Bergwall, 47, is president of Princeton Entrepreneurial Resources, a firm in Princeton, New Jersey, that maintains a database of 4,000 managers seeking temporary jobs—overseeing a short-term project, for example, or helping launch a new product or reorganizing a department. An interim manager's contract typically provides a salary, without benefits, for a specified period, although some stay on permanently with a company if they find a good fit. "The whole interim-management industry is built on the disenchantment of middle managers," says Bergwall. "People come to us because they feel powerless over their careers in big companies." Although her firm doesn't advertise or otherwise promote its

Hyatt finds that listening to employees, as at this session in Chicago, helps boost customer satisfaction.

services, she says that word of mouth brings in 500 new résumés a month.

Suppose you would rather keep your best middle managers than see them toot off to temping. What can you do? A few companies have found ways to empower people for real, even in the midst of economic bleakness. Much of what works best is so commonsensical, so *obvious*, that it tends to get overlooked.

Too often, the experts say, top management focuses its concern only way down below, in the hourly and clerical strata, telling the folks in the middle, "We're empowering you to fix this," while forgetting that in tumultuous times middle managers already have additional problems aplenty. "The best companies concentrate on managers' concerns *first*," says Peter Gelfond, who directs research at the Hay Group. "Otherwise you get what I call supervisory scapegoating. The manager conveys, either in words or attitude, to the people under her or him, 'Top management doesn't give a damn about me, so they probably don't really care what happens to you either.' "

Toro's Fournier (left) and Melrose let employees structure the restructuring.

TO ACHIEVE real empowerment, and improve morale in the middle, follow three basic steps. First, find out what people are thinking, what they believe the problems in the company are. Second, let them design the solutions. Finally, get out of the way and let them put those solutions into practice.

This regime may be difficult for top managers who rose in hierarchical organizations where orders came from the top and the chairman was never wrong. But the drill can produce impressive results. Executives who follow it find that productivity goes up, customers are happier, and the company is better able to face the competitive music.

Almost without exception, the best way to find out what people think is to ask them. Surveys that permit employees to respond anonymously are gaining in popularity in corporate America. The most enlightening polls, companies find, are those that ask the toughest questions. United Technologies started five years ago trying to change its culture by empowering the lower echelons, cutting red tape, and continually improving quality. It has also eliminated 7,500 jobs. Now the company is asking employees to assess how much progress has been made. "No one person is smart enough to know what is going on in every part of a company this big," says Franklyn Caine, a senior vice president. "And a survey puts in front of people the fact that you really do want to change, and you're ready to do what that takes."

The questionnaire is one facet of a wholesale training effort aimed at altering employees' perceptions of the company, the job, and the market. The Readiness-to-Compete Survey, as it is called, went out in April of this year to 7,000 workers, including some 500 middle managers who had been carefully briefed beforehand. Part of it asked respondents to rank, on a scale of 1 to 5, the seriousness of ten obstacles to competitiveness. These include: "Management complacency; indifference; lack of urgency"; "Management not really committed to change"; "Reactionary management, not proactive"; and "Ineffective immediate supervisor." The quiz ends with plenty of space for further comments.

Says Caine: "We wish we'd done this five years ago so we'd have some basis for comparison after we analyze the answers." Now he's trying to persuade other technology outfits to ask their people the same questions, so each company could compare its findings with the industry aggregate.

Many companies doing surveys also send out managers—top, senior, middle—to ask the same questions over again in person. Even anonymous polls may not elicit truthful responses, and there is nothing quite like being there face to face. Karl Krapek, 42, head of United Technologies' Carrier Corp. subsidiary, has spent the past few years crisscrossing the country, having breakfast, lunch, and dinner with the troops. In the past year he has met and chatted with more than 9,000 employees. Sometimes he talks, but mostly he listens. "The main thing is not to come with prepared notes," says Krapek. "You want to get a dialogue going. You want people to speak up."

Understandably, this is not always wonderful for the ego of the top manager sitting there listening. But do you really want what TV networks call "happytalk," or do you want honesty? Says Carrier's Krapek: "People don't crab about their parking space or their merit raise. They usually want to know why we do certain stupid things that don't help the customer."

The best companies concentrate on managers' concerns *first*, so that they don't pass along a bad attitude.

Ah, the customer. Hyatt Hotels has been surveying all employees at its 106 hotels in North America for 15 years. Although its questionnaire includes some 100 items, the answers to seven key queries—one of which is "Tell us what you think of management"—make up the general morale index, or GMI, that Hyatt's top officers watch most closely. The company has just finished developing a computer program that compares employees' attitudes in each location with what

REPORTER ASSOCIATE *Tricia Welsh*

guests say on those how-did-you-like-your-stay postcards in Hyatt's hotel rooms. Guess what: The hotels with the highest GMI scores also rack up the highest ratings from customers—and, not coincidentally, the highest sales and gross operating profits.

Fifteen years ago the hotel company began a monthly regimen of employee get-togethers with senior management, called Hyattalks. "Patrick Foley, the chairman at the time, insisted on it," recalls Darryl Hartley-Leonard, 47, now Hyatt's president. Hartley-Leonard, an Englishman, began his career with Hyatt as a desk clerk in Los Angeles at age 20. As a regional vice president under Foley, he at first had his doubts about facing crowds of employees in person: "I thought, 'Oh, no, people are just going to complain.' But it has changed the whole organization." He credits the talks with keeping Hyatt's employee turnover low, especially among middle managers, whose average age is 40 and length of service 15 years. Hyatt execs say they believe the company still has more than half of all management-track types it recruited out of college since the mid-1970s, and has hired only about 5% of its managers from outside over that period.

At Toro in Bloomington, Minnesota, the rank and file have owned 20% of the company through an ESOP since 1985. "If you're going to ask people to own the goals of the company, you have to give them a tangible piece of it," says CEO Kendrick Melrose. "It's just putting your money where your mouth is." An early proponent of empowerment, he puts in occasional sessions on the assembly line, tries to eat lunch at least once a month with employees, and answers customer-service telephones.

Sales of Toro's lawn mowers and snow blowers declined in the latest downturn, and last fall Melrose asked all managers in the company to cut their budgets by 10%. Some did better than that. Louis Fournier, who runs materials purchasing for the consumer division, slashed travel expenses by 60%, partly by persuading suppliers to come to Bloomington now and then instead of expecting constant visits. At employees' suggestion, he also cut paperwork. "We used to circulate a 400-page printout every week that detailed everything we were doing," he says. "That's gone. And for every other report we do, we keep asking, 'Do you really need to see this every week? How about once a month? How about not at all?' "

Toro undertook layoffs only as a last resort. About 70 people, out of a total of 1,300 salaried employees, have been let go; some employees volunteered to leave so others wouldn't have to, and some took salary cuts or moved elsewhere in the company. "But there were no edicts from above," says Fournier. "We made all these decisions ourselves." Says William Hayes, formerly a director of three company groups: "I had to dismiss one person, and would have had to dismiss another, so I instead decided to retire myself—it wasn't so far down the road for me." Toro turned a profit in 1991. "Had we been more top-down and autocratic, we wouldn't be doing so well," Melrose says. "But you have to start building this kind of culture long before a crisis begins. My advice would be, 'Start now, and you'll be ready for the recession of 1998.' "

"I had to dismiss one person, and would have had to dismiss another, so I instead decided to retire."

In most places, middle managers will remain faced with the same dreary realities that now beset them, but with fewer opportunities to move up as companies keep carving layers out of the old hierarchy. Here and there, a forward-looking corporation is making a serious effort to help white-collar folks confront the new realities. Prudential began last year to offer 2½-day seminars that give managers a chance to take aptitude tests and to think about where they've been and where they're going.

Managers whose aptitude-test scores and introspection lead them to think they're in the wrong job can ask for a transfer. Susan Pitonak, 31, spent eight years as an accountant and was attending Rutgers University in the evenings to earn a master's degree in finance. The seminar she attended helped her clarify the restlessness she had been feeling as she stared at columns of numbers all day. She now works in training and development, and has changed her master's specialization to human resources. Says Pitonak: "The seminar asks you to look at every job you've had, why you chose it, why you left it—and what does success mean to *you*?"

IT SEEMS UNLIKELY that the answer to that question will ever again be: "Toiling loyally for my company, even if I'm overworked, underappreciated, and wouldn't know empowerment if I tripped over it." Unhappily for CEOs and division heads who still expect such loyalty—where have they been?—the advice that career counselors are handing out these days won't bring back the Organization Man (or Woman either).

William Morin, chairman of Drake Beam Morin, the biggest outplacement firm in the world, distills the lessons for middle managers attempting to plan their careers. "Big corporations are still demanding old-style loyalty," he says, "but at the same time everyone knows they're offering packages to clear out as many people as possible. That mixed message is not lost on anybody." As a consequence, Morin and many other experts encourage managers to think of themselves as independent, marketable entities: "The attitude for the Nineties is not, 'I work for XYZ Corp. and I happen to be an administrator.' No. The idea now is, 'I'm a very capable administrator—and I just happen to work for XYZ Corp. at the moment.' "

Or, as they used to say on Wall Street in the Eighties: Never love a company, because a company will not love you back. F

Morin sees a new employer-employee contract.

CEOs THINK THAT MORALE IS DANDY

Are there unhappy managers out there? Not at my company, says the typical corporate chief. But the top guys are trying to strengthen lines of communication. ■ *by Anne B. Fisher*

To make use of a phrase that has been growing rapidly in popularity these past few weeks: When it comes to the managerial morale crisis, CEOs just don't seem to get it. That's the clear implication of FORTUNE's poll of 212 chief executives of America's largest companies, conducted by the opinion research firm Clark Martire & Bartolomeo. Fully 91% of the top brass believe that morale in their companies is just fine. And 59% think that satisfaction among middle managers is either "excellent" or "very good," with only one CEO in ten conceding that morale at that level is fair or poor. While many middle managers and the people who conduct surveys of their attitudes say that their enthusiasm for work has declined in the past three to five years, 58% of chief executives think morale has gotten *better* over that period of time. About one-quarter of the CEOs in the survey said morale has stayed the same, and just 16% have noticed a decline.

All this despite the fact that most chief executives report they are making a herculean effort to stay in touch and to keep people in the picture and on board. They are communicating with employees in regular meetings, conducting employee surveys, and churning out newsletters and informational videos. "We've tried to build an organization that's congruent with the highest side of human nature," says William J. O'Brien, 59, CEO of Hanover Insurance Co. in Worcester, Massachusetts. "The fundamental movement in business in the next 25 years will be in the dispersing of power, to give meaning and fulfillment to employees in a way that avoids chaos and disorder."

W. Thomas Stephens, 49, chairman of Manville Corp., with its history of asbestos problems, likens a session with employees to an "old-time revival meeting. We had a psychiatrist in to do a study for us, and we learned that, in times of stress, communication has to increase exponentially or you won't survive."

Richard F. Teerlink, 55, CEO of Harley-Davidson, explains, "It's a matter of top management getting out and talking with people, not at people . . . We're making progress, but we still have a long way to go." Says Alan G. Hassenfeld, 43, CEO of toymaker Hasbro in Pawtucket, Rhode Island: "We

Q In the past three to five years, has morale among your middle managers improved, stayed the same, or gotten worse?

A

Improved	58%
Stayed same	25%
Gotten worse	16%
Not sure	1%

Q How would you describe morale among middle managers in your company?

A

Excellent	15%
Very good	44%
Good	29%
Fair	11%
Poor	1%

Q How would you characterize morale at your company? As a whole, would you say it is . . .

A

Excellent	21%
Very good	45%
Good	25%
Fair	9%

"We learned that, in times of stress, communication has to increase exponentially or you won't survive."

W. THOMAS STEPHENS
Chairman, Manville Corp.

"It's a matter of top management getting out and talking with people, not at people."

RICHARD F. TEERLINK
CEO, Harley-Davidson

"We are meeting more often with senior management in small groups, and they are doing the same with middle management."

ALAN G. HASSENFELD
CEO, Hasbro

have a program called 'Write to the top' in which everyone is encouraged to write to me about anything that's on their minds, and it's read only by me. We are meeting more often with senior management in small group settings, and they in turn are doing the same with middle management."

Nearly 60% of the chief executives say they conduct employee surveys regularly, and most of those bosses claim they augment the surveys with frequent personal contact. But some concede that restructuring still takes a toll on employee attitudes. "We've worked hard at bottom-up, two-way communication," says Richard A. Clarke, 61, chairman of Pacific Gas & Electric in San Francisco. While removing layers of management has been good for that, it hasn't helped middle-management morale." So in addition to employee surveys and a twice-a-year video presentation to all 80 PG&E locations, Clarke holds monthly brown-bag lunches where managers can ask questions or air gripes. The lunches "develop a good dialogue," Clarke says.

With all those chief executives out there communicating like crazy and believing that their efforts are giving morale a shot in the arm, why are middle managers and professionals still feeling unappreciated and cut off? Could it be that when the boss asks for an employee's opinion on the really tough issues, the employee is less than candid? Some who have pondered the question think so. Manhattan consultant Dee Soder recalls hearing a conversation between two middle managers about an anonymous employee survey they were being asked to fill out. Said one to the other: "Oh, come on, you're not going to write down what you *really* think, are you?" That, says Soder, is a common attitude, and one that defeats the purpose of doing surveys at all.

Consultant and author Robert Kriegel agrees. "Most middle managers really do not want to rock the boat," he says. "They tell their bosses what they think their bosses want to hear, and then go home and seethe privately." Kriegel says this is a shame, since in his view many top executives really do want to know what their subordinates are thinking. The FORTUNE poll of chief executives strongly suggests that he is right. Could it be that those middle managers who don't speak up have no one to blame but themselves? F

REPORTER ASSOCIATE *Tricia Welsh*

Q A

Does your company conduct regular surveys of its employees?

Yes	59%
No	41%

Q A

Do you find these surveys helpful?

Helpful	93%
Not really	6%
Not sure	1%

Q A

What has your company done in recent years that has most helped to improve communications and productivity?

Regular meetings with employees	41%
Quality-improvement programs	20%
Incentive-based compensation programs (e.g., stock options, profit sharing)	17%
Internal newsletters/bulletins	16%
Team effort/employee involvement	11%
Informational videos	10%
Surveys/focus groups	9%
Delayering organization	7%
Training middle management (in human resources, etc.)	7%
Better communication between all layers of management	6%
Broadened participation in decision-making	3%
Instituting grievance panels/hotlines	2%
Other	5%

Adds to more than 100% because of multiple responses

THE BILL IS DUE AT AMERICAN EXPRESS

Growth was so easy for the company in the 1980s that it lost touch with its customers. Now it faces the difficult job of wooing them back. Has Amex peaked out? ■ *by Bill Saporito*

IF AMERICAN EXPRESS CO. were a person, it probably wouldn't be eligible for one of its own cards. Who'd give charge privileges to a corpus with an erratic earnings record, an inability to handle debt, and an increasingly questionable reputation vis-à-vis its peers?

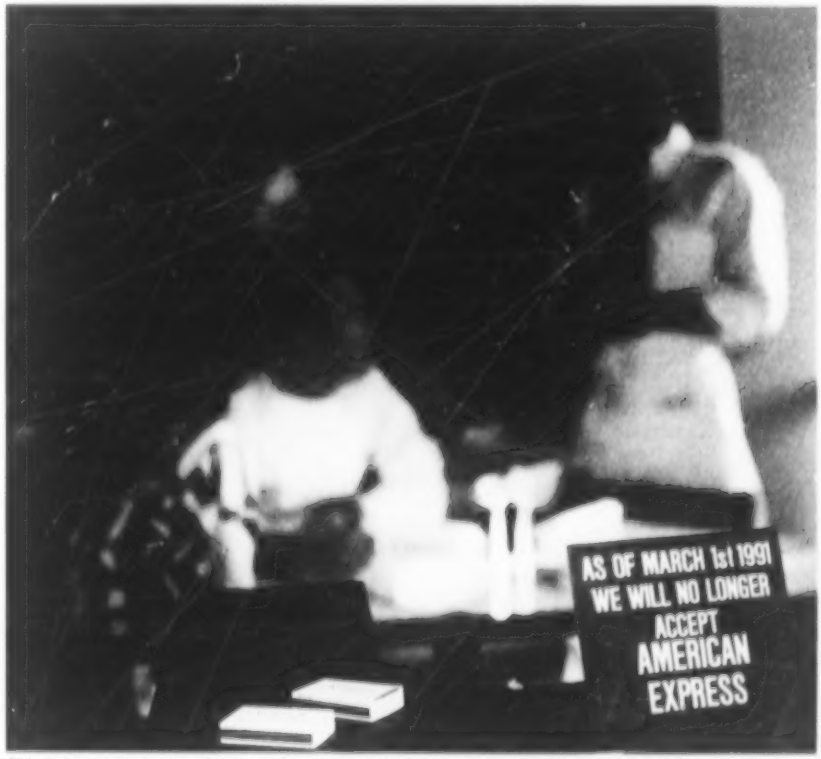
Calamity is getting to be a quarterly event at the company. In October a bad-debt bombshell exploded at the company's Optima credit card operation, triggering a $24 million write-down. Another $131 million in charges against earnings came from bad loans to gold and platinum cardmembers with credit lines and from delinquencies among the fly-now, pay-later bunch. Finally, the company waved goodbye to $110 million to restructure the Travel Related Services division, the business that issues charge cards and traveler's checks. It all added up to a 91% decline, to $31 million, in third-quarter earnings.

While the Optima trouble got the press play, the travail at Travel is the most ominous news. TRS, as the division is known, is the flagship, accounting for $9.7 billion of the company's $24.3 billion in revenues last year and $956 million in earnings. But this hitherto proud vessel is being buffeted by sustained competitive furies that Amex has never experienced before. Says the company's newly appointed president, Harvey Golub: "To the extent that TRS is successful, this company can do anything it wants and withstand almost anything. And to the extent that it is not, it doesn't really matter what happens outside of TRS."

In response to the competitive onslaught by bank cards, American Express now plans to recast itself as plastic's gold standard, with a strategy that—roughly translated—affords cardmembers the privileges they thought they were already getting and then some. Says Kenneth I. Chenault, president of the domestic consumer card division: "Frankly, the thrust of the Seventies and Eighties was to simply acquire the customer. But that clearly is not enough." Amex will sacrifice some increase in its numbers to concentrate on its best cardmembers, with the aim of getting them to charge more on Amex than on their other cards.

The plan also calls for the company to make magic for merchants that accept the card by increasing advertising and promotion and by downsizing its mail-order business so as not to compete with them. Amex also plans to slug it out with the bank cards, in some cases lowering the discount rate, the company's cut of each sale the merchant rings up on an Amex card.

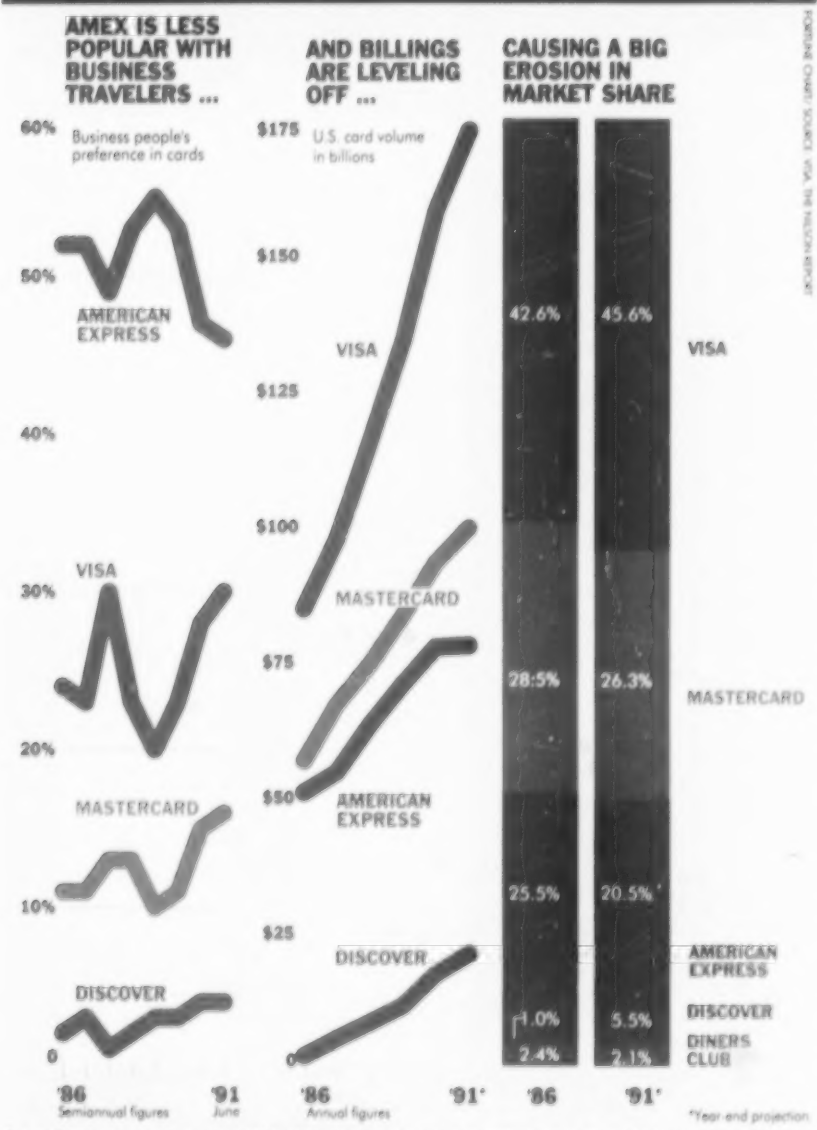
This aggressiveness could pinch TRS profits next year. For instance, according to Robert Hottensen Jr., an analyst at Goldman Sachs, reducing the discount rate 25 basis points will cost $250 million in operating earnings. But CEO James Robinson III, who is already just about out of friends on Wall Street anyway, is resolute on the point. Says he: "We've proven that we can deal with some tough situations. We did so with Fireman's Fund and realized great value for the company when we sold it. We're doing so with Shearson now, and we'll handle the



Chic restaurants such as Azalea in Atlanta are refusing the card, citing Amex's high fees.

PHOTOGRAPH BY ANN STATES—SABA

THE SUPERIORITY GAP NARROWS AT AMEX



According to research conducted for Visa—Amex declined to provide its own—46% of business people cite American Express as their preferred card, while 30% choose Visa, a new high. Recession hit Amex white-collar cardmembers hard, and its billings stagnated while Visa, MasterCard, and Discover all gained. Amex's market share has shrunk, but card charge volume is growing.

different but challenging aspects at TRS." The stock market is less sure: American Express shares have dropped 27%, to $19 from $26, since the company announced the bad news about the October write-down.

Stockholders can still take comfort from Amex's strengths. Despite its problems, Goldman Sachs's Hottensen estimates that TRS will earn $425 million this year on revenues of about $10 billion, and by any measure it remains a top-flight provider of customer service. The corporate card side of TRS, for example, has more than five million cards in the hands of employees of most of the FORTUNE 500 industrial companies. It has cornered about 80% of the business card travel and entertainment market, which generates $25 billion in spending, roughly a third of Amex's total domestic billings of $78 billion.

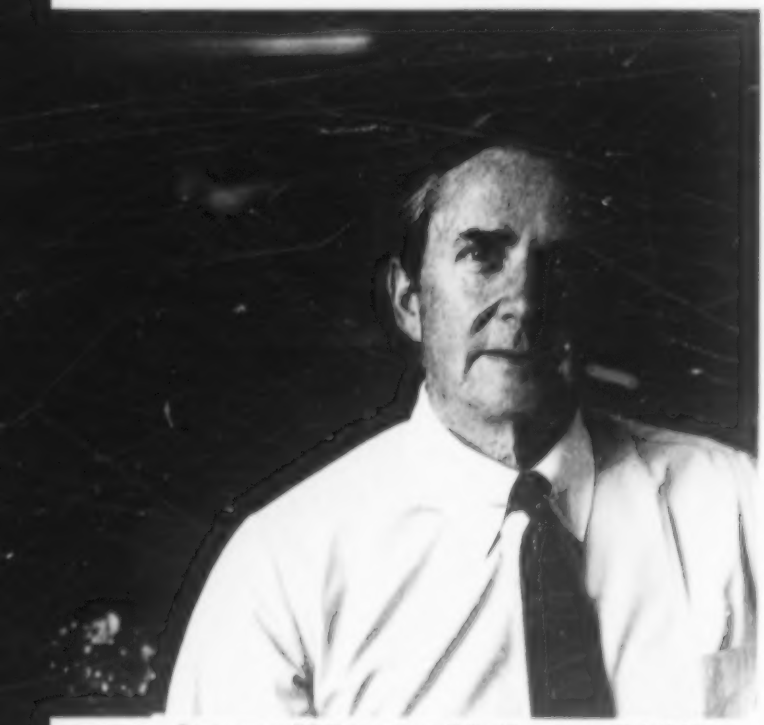
The company's Shearson Lehman Brothers division, last year's hotfoot, is back in solid shape and gaining momentum, helped by cost cutting and a blossoming market for equities (see box). IDS Financial Services, the Minneapolis-based financial planner to the middle class, continues to enjoy growth in sales and earnings, and should chip in $245 million on revenues of $2.5 billion in 1991. Informational Services Corp., a division with expected revenues of about $1 billion and earnings of $120 million this year, is bumping along through the recession quite nicely. ISC's biggest business? Processing Visa and MasterCard charges for the institutions that issue those.

But the write-offs in TRS and the Optima card suggest a dawning struggle for a company once thought to be among the nation's best-managed service companies: Could it be that American Express has lost touch with its basic customer, the consumer? The years the company spent expanding its cardmember base have eroded the card's position as the premium-priced plastic for upscale business travelers and for those aspiring to be.

THE CLIMB BACK to its lofty perch as the plastic you gotta have is going to be difficult for American Express. No one doubts its ability to deliver expanded service. The question is, Do consumers really want that now, and the status that goes with it? Says Laurel Cutler, worldwide director of marketing and planning at the advertising agency FCB/Leber Katz Partners: "Prestige is less of a Nineties concept than an Eighties concept. God knows, function, utility, and what you get back for what you pay is the name of the game for most people today."

Some experts say the company will never regain its former heights. Argues Spencer Nilson, publisher of the *Nilson Report*, an industry newsletter: "American Express's market share is going down and may never go up again. They have inherent problems that will be hard to resolve." Nilson believes the way consumers view cards is shifting, from status symbol to payment device, and that it will be prohibitively expensive for Amex to change that attitude. Adds a rival

REPORTER ASSOCIATE *Joshua Mendes*



Do you owe me? Optima gave a portfolio of loan charge-offs to Robinson.

in the card business matter-of-factly: "American Express has seen its best year."

The challenge to American Express's green, gold, and platinum card business has been growing since 1989. That's when Visa USA, the consortium of financial institutions that issue the cards, began targeting Amex instead of its traditional rival, the MasterCard association. Bank card issuers make most of their money charging annual fees and interest on unpaid balances. Amex also makes a bundle on annual fees, but 65% of its revenues come from the merchant discount. Last year discount-fee income amounted to $3.7 billion. Too much, to some eyes. Says Frank Partel, an industry consultant and former Amex executive: "American Express has been aware for some time that its Achilles' heel has been the discount income."

Banks issuing Visa have been taking aim at that heel, whittling the fee down to an average 1.82%, while Amex continued charging 3.25% to over 4%. Amex executives did nothing in response, believing Visa's rate would be unsustainable over time because such a low fee made the transactions unprofitable for the banks. But the bank card issuers got lucky: The cost of money began to fall, from 7% in 1989 to about 5%, while the interest rates consumers paid drifted ever upward, to 19%. Says Harvey Golub: "That wonderful spread enables them to have uneconomic discount rates with merchants."

Amex also did nothing when some of the largest credit card issuers, Citibank and First Chicago, began poaching its best business travel customers by introducing affinity cards that awarded mileage on frequent flier programs for each dollar charged on the issuer's card. Again, Amex executives estimated that the 1-cent-a-mile cost, or $200 on a card that runs up $20,000 in billings, was uneconomic and therefore unsustainable.

They were half right. Says Robinson: "We watched the market share go away to the affinity card, and we chose to ignore that shift. A number of affinity cards came and went, so the approach was not necessarily wrong." But some programs came and stayed. Forced to respond tardily, Amex started its own frequent-traveler program, called Membership Miles, that awards mileage on a variety of airlines in exchange for charge volume. The company claims it is winning back its lost travelers.

The bank cards also began touting their own special perquisites, while at the same time matching Amex on goodies such as free travel accident insurance. With its lowered discount fee, Visa also began adding merchants at a rapid clip: Today the card is accepted in nearly three times as many places as Amex cards. In ads showing sleek couples in faraway places, Visa pounded the card message home: "Visa. It's everywhere you want to be." Amex never intended its cards to be used everywhere—there's no exclusivity in that—but Visa has made acceptance a competitive issue.

"To the extent TRS is successful, this company can do anything it wants. To the extent it isn't, it doesn't matter what happens outside TRS."

THE KEY to Amex's success over the years was selling the merchants on a "plus business" strategy, meaning that a blue decal on the window would bring in additional sales from blue-chip buyers. For years Amex had no problem demonstrating that its cardmembers spent considerably more than users of other cards. But that story has become less compelling now that there are more high-income Visa and MasterCard gold card holders than there are holders of American Express cards of all colors. Merchants know that nearly 90% of Amex holders also carry bank cards.

In the last year, with recession choking retailing, merchants began to "suppress" Amex, in the company's phrase—asking their customers for another card instead. And some stopped taking the card altogether. So cardmembers were being greeted increasingly with grudging acceptance or none at all. Some privilege. Amex's status as the business person's preferred card for travel has been slipping, according to Visa's research (see chart).

The problem boiled over earlier this year in what became known as the Boston fee party. Boston restaurateurs, taking a beating from a recession that has laid New England low, asked Amex either to cut the discount fee or to boost marketing support. Their pleas unheeded, they began refusing to accept the card. Soon restaurateurs all over the country were threatening to do the same. Says Chenault: "That was the wake-up call." But Visa and Discover heard it too. Visa agreed to pay for legal representation for the revolting Bostonians, and a Discover swat team descended on the city and increased Discover's penetration of the market from 20% of Beantown's beaneries to 75%.

Amex responded by reducing the discount rates to restaurants across the country that clear their transactions electronically rather than by mail. But once it lowered its rate for restaurateurs, other merchants wasted no time in asking for similar treatment. The blood is clearly

in the water. Says Philippe Gadbois, director of marketing for Hilton International, owner of the Vista hotel chain in the U.S. and Hiltons abroad: "The big picture, as you might surmise, is that there are extremely important discussions between us and Amex." Nor is Hilton International the only chain to invite the company over for tea and crimping. A merchant agreement with Amex is essential to any hotelier, but Gadbois notes, "Competing products have come a long way."

No one is more aware of that than Harvey Golub. Robinson—who has a knack for appointing and then losing superb No. 2s—has charged him with the responsibility for remaking TRS. Until Robinson made him president last July, he had been running IDS, transforming a good company into a sterling performer. And after eight years in Minnesota, even a Brooklyn boy like Golub knows a wounded duck when he sees one.

Says he, in the kind of frank admission that would never have dribbled out of the mouths of TRS executives in the past: "The TRS company is really at a crossroads. What will be interesting and important to us is to define the current reality in terms that are stark and clear to people. And based on that reality, to decide on our future vision and the strategy that we're going to pursue to get that vision implemented. And then to get on with it. And I guess the question is to what extent will we be able to do it and when will we know."

AMEX will focus its attention on its best cardmembers, the 20% who do 80% of the charge volume. Says Robinson: "We're going to start with tenured cardmembers, from charter members forward, and design and introduce service for them in ways nobody else can, focusing on them with an individuality that we have not done before." But even lesser lights will get what the company is calling "Service for the 1990s." For instance, a cardholder traveling in Mongolia could not only get a lost card replaced quickly but also change travel plans, find a restaurant nearby, and have a letter delivered to a client—all with one phone call. Amex describes this concept as 100% resolution.

At home the focus will be on a combination of personal marketing and service benefits. For example, each cardmember could receive his or her monthly statement on the day he wants and in whatever form he wishes—with or without charge duplicates, say. A customer who plays golf and likes antiques would receive entirely different mailings from those who prefer jogging and modern art. The company is already laying on more special treats along the lines of reserving tickets to tennis matches for sale to the tennis nuts, or to cultural events for gold or platinum card members.

For the service establishments, or SEs, as the merchants are known in Amex parlance, the news remains mixed. The company says it wants to return to those wonderful days of yesteryear when merchants valued the blue decal in their windows. Golub has promised to be more attentive to such merchant concerns as discount rates, speedy payment, and marketing support. Merchants, some of

TO THE RESCUE AT SHEARSON

Even as American Express strayed from the values that had made it successful in its main business, an infusion of old-style Amex management precepts is reviving Shearson Lehman Brothers. After the brokerage firm lost nearly $1 billion from investments in junk bonds, real estate, and soured deals, Amex shoveled $1 billion of new capital into the business and then vigorously cleaned house. Exit dealmaker Peter Cohen as CEO; enter a new boss, Howard Clark Jr., the parent's chief financial officer. Clark brought with him Jonathan S. Linen, former co-head of TRS, and placed him in charge of the retail brokerage.

The two men forced Amex's customer-driven values on a somewhat outlaw organization. In the 15 months through August 1990, Shearson paid out a numbing $14 million in arbitration settlements to disgruntled clients, three times as much as any other brokerage firm. The sales force was clearly ready for a code of conduct based on Amex's Blue Box Values, something along the lines of "Don't screw the customer." To reinforce this notion, each broker's desk was equipped with a "table tent," or folding card, on which the precepts were neatly printed.

To make its intent absolutely clear, Shearson dismissed 180 sales reps for violating those precepts, even though together they were pulling in more than $40 million in gross commissions—big numbers.

Along the way, Shearson also wrung costs out of its operations by closing 110 branches. The company then established expense and operations benchmarks for the 400 still standing, based on the best practices of the top 75 offices. As a result, operating costs in the branch system have dropped by 25%, and operating expenses have been pared firmwide by almost $440 million since 1989.

Shearson has also begun to digest its parent's emphasis on prestige service. The brokerage has bifurcated itself: The investment banking side is now known as Lehman Brothers, reviving an honored, old-line name, and the retail sales operation goes by Shearson Lehman Brothers. Clearly enjoying its rediscovered pedigree, Lehman Brothers has increased its market share in the underwriting business some 50% over last year, according to Clark, and is lead manager for roughly $2 billion of equity securities slated to come to market later this year. The company recently moved to No. 3 from No. 6 in the value of domestic issues it has lead-managed.

If good luck is a result of good planning, Shearson is about to make some hay. A booming equities market has arrived, and Goldman Sachs estimates that the firm's profits will be about $150 million this year. "This is the miracle of management," says Linen. "When you have your revenues going up and your costs going down, it's just amazing what happens."

Shearson is by no means trouble-free. The company needs more capital, and it may have to withstand more write-offs. Moreover, the strength of its conversion to Blue Box Values has yet to be tested in a sluggish market. But with a tangible net worth—tangible assets less liabilities—of $722 million, up from almost zip 2½ years ago, Shearson is now in a position to earn back for Amex shareholders some of the money they put into it.

Golub is blunt: "We do require significant changes in our strategy."

whom haven't seen anyone from Amex in a long time, can expect a visit by service representatives empowered to make deals on the spot if a problem arises.

But woe to those service establishments that continue to suppress the card. Robinson is promising retribution. Says he: "We can't sit there and have them sign a contract with us, accept our customers, and then try to switch our customers off to another product." The company is also reevaluating its merchant base using new criteria to determine where the company will spend marketing money and, in particular, which sectors it will try to expand. Although Robinson doesn't expect to purge many SEs, he insists that in the future the company will be choosier about adding new ones.

AMEX'S OTHER troubled business, Optima, affords yet one more example of how badly it had lost touch with its customers. Optima was launched with a design flaw that almost guaranteed above-average losses. The company offered it only to current T&E cardmembers, who it believed were the perfect targets for revolving credit since they paid their bills religiously. What the company failed to realize is that a big portion of all T&E charges are business expenses for which the cardmember is reimbursed. Thus, he can afford to keep that bill current.

By contrast, many Optima cardholders used their cards strictly as a credit device—they already had Amex T&E cards for payment convenience—and about 95% of the Optima accounts ended up being rolled over, that is, the balances were not being paid off every month. And some were never paid. Early last year, Optima faced charge-off rates near 5%, tops among the big issuers. By the second quarter the percentage nearly doubled.

Like all credit card companies, Amex creates models to predict a portfolio's behavior. But the models used historical data, in some cases two years old, on which to make assumptions about unemployment and personal bankruptcy rates. As the saying goes, Optima's credit managers had their heads in the past and their posteriors to the future. By the first quarter of this year, the models were hopelessly out of date: The personal bankruptcy rate was soaring, for instance, but a revised number never made it into the equation.

Executives of American Express knew the portfolio was deteriorating, but the third-quarter projections were shocking. Sources say Optima credit managers apparently failed to write off some busted accounts. Instead, they believed that many bad accounts could be "cured," or negotiated to become current. They also anticipated a general economic recovery. Didn't we all.

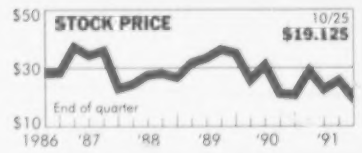
Early next year the company plans to relaunch Optima as a hybrid T&E-credit card, offered only to existing cardmembers. Those cardholders who exercise "financial responsibility" by paying off perhaps 30% of the balance each month will get a rebate or other reward later. Those who want to finance their entire balances will likely pay the market rate, currently about 19%.

The problems at TRS and Optima represent a kind of cultural meltdown that occurs when "winning" organizations are faced with the opposite. The company's mission statement, known as the "Blue Box Values" after the corporate logo, talks about "Conduct that reflects the highest standards of Integrity" and "Teamwork—from the smallest unit to the enterprise as a whole." Neither was visible at Optima, where lower-ranking managers were so fearful of reporting bad news that they compounded their mistakes in a frantic effort to make their numbers. And apparently no one on the TRS team had enough courage, or clout, to admit what was happening to the business.

To Robinson, who stumps endlessly for quality, the failure is disillusioning. Says he: "Any company will have pressure to meet the budget—should and will—but everybody needs to know that you must also communicate reality."

In the short run, there's no need to fret about the future of American Express. Robinson's decision to invest in savings-oriented businesses such as IDS and Shearson is paying off now, with both in a position to pick up earnings and bail out TRS. Moreover, if company executives are wrong in their current approach to TRS, they'll still have time to make midcourse corrections. A franchise this magnificent, Mr. Robinson's critics should note, can survive almost any management. But not forever. F

AMERICAN EXPRESS



A series of misadventures at divisions such as Fireman's Fund (since sold), the Boston Co., and Shearson Lehman has punished Amex.

SALES (latest four quarters) Change from year earlier	**$25.4 billion** Up 4.5%
NET PROFIT	**$686 million** Up 128.6%
RETURN ON EQUITY	**9.3%**
TOTAL RETURN TO INVESTORS 12/31/85–12/31/90 (annual rate)	**–2.0%**
PRICE/EARNINGS MULTIPLE	**13.6**
DIVIDEND YIELD	**4.9%**

CAN YOU TRUST THAT AUDIT?

The government doesn't—it's suing three of the Big Six accounting firms over their work on S&L financial statements. Here's what's being done to audit the auditors. ■ *by Rahul Jacob*

IT MAY BE TIME to revise the notion that accountants are boring. Ever since the savings and loan scandals broke, auditors have been something of a spectacle. Not only have their audits been roundly criticized in virtually every major S&L debacle, but in addition the Federal Deposit Insurance Corp. and the Resolution Trust Corp. have sued or settled with five of the Big Six, in most cases alleging negligence. The remaining member of this beleaguered sextet, Price Waterhouse, is embroiled in controversy over an audit that its London affiliate performed for Bank of Credit & Commerce International.

A slow-growth economy has made things worse, increasing the competition for auditing clients to a frenetic, almost farcical, level. This raises the concern that heavily discounted audits will prove to be sloppy audits. No wonder investors, managers, and creditors are becoming skeptical about the auditor's imprimatur on financial statements! Anyone who relies on the numbers in an annual report must grapple with a profoundly unsettling question: Can you trust that audit?

The short, reassuring answer: Yes. Despite all the *Sturm und Drang*, allegations that auditors have been negligent run at less than 0.5% of all audits performed for the more than 12,000 companies that submit financial statements to the Securities and Exchange Commission. These numbers are roughly the same as five years ago. The bad publicity has nonetheless jolted the auditors into action. The profession's national association, the American Institute of Certified Public Accountants (AICPA), has adopted tough new rules to plug the gaping holes exposed by the S&L disaster. The firms are putting more emphasis on training employees and are demanding that their accountants become specialists in clients' industries.

The accountants' tough times stem partly from the mergers and acquisitions binge of the Eighties, followed by the bankruptcy hangover of the Nineties, which left fewer clients all around. The firms are scrambling after those that remain, often cutting fees and aggressively pursuing accounts outside the FORTUNE 500 industrial and service companies. Robert Willens, an accounting analyst for the Lehman Brothers investment bank, maintains that many audits are being done at 40% to 50% of the standard fee. Says he: "Fee cutting is rampant." In an arrangement that industry insiders say is not unique, Price Waterhouse snared a Wall Street client last winter by offering to do the first year of a three-year audit engagement free. The firm denies this but refuses to disclose the specifics of the deal.

All this has made a sizable dent in industry revenues, including those of the Big Six—although they resolutely maintain that their audit businesses are profitable. (As private partnerships, the Big Six firms are not required to release financial infor-

REPORTER ASSOCIATE *James A. Anderson*

ILLUSTRATIONS BY SEYMOUR CHWAST

mation.) Audit's share of Big Six revenues declined from 62% in 1982 to just under 50% last year, according to *Bowman's Accounting Report*. Their remaining business comes from consulting and tax work (see table). In 1990, Big Six audit receipts did not even keep pace with inflation, growing only 4.3%, vs. 5.4% for the consumer price index, and way down from the 10% these firms averaged annually through most of the Eighties.

The impact of fee cutting on the quality of audits is harder to gauge. If a firm is being paid less, it seems reasonable to believe that it will commit fewer resources to the job. Says Steven Oppenheim, formerly of Spicer & Oppenheim, a New York City firm that disbanded last December after it lost many of its brokerage clients: "Auditors are human. When you substantially reduce audit fees, you reduce the time spent on an audit."

A 1989 report by the General Accounting Office (GAO) on 11 failed thrifts found many instances when auditors did not adequately check managements' oral assertions that problem loans were collectible. An auditing firm cited in the study had doubts about the appraisal values of collateral for one thrift's loans but failed to check the appraisals independently.

Willens, the Lehman Brothers analyst, does not think the quality of audits has suffered because, he says, "the firms themselves are bearing the brunt of the discounting." He points to the layoffs of professional staff at Deloitte & Touche, Ernst & Young, and Peat Marwick (which dismissed 265 *partners* last spring) as anecdotal evidence that rather than corners, fat is being cut. Jon C. Madonna, Peat Marwick's chairman, agrees: "We had too many partners. We were flabby like other businesses," he says.

Moreover, the courts are finding it difficult to make a straight-line correlation between a failed S&L and a faulty audit. Last month a federal judge in Dallas disagreed with the FDIC's contention that one of Ernst & Young's predecessor firms contributed to the failure of the Western Savings Association; he threw out the FDIC's $560 million suit against the auditors.

Before you can assess whether you should trust an audit, you need to know what it is—and is not. Many shareholder and depositor lawsuits stem from the expectation gap that yawns between what auditors actually do and what the public thinks they do. First and foremost, just as the auditor's letter in any annual report says, an audit can offer only "reasonable assurance" that the financial information is free of "material misstatements." The definitions of "reasonable" and "material" are foggy, but what the auditor's letter means is that the numbers are free of unintentional errors big enough to give an inaccurate view of the company's financial position.

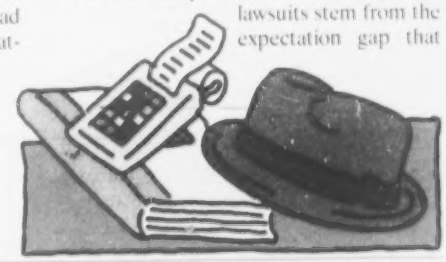
Generally accepted auditing standards, the guidelines laid down by the AICPA, require that auditors understand the client's business and its internal controls. But it would be incredibly costly to check a client's every transaction, so the auditors rely on samples and, with the help of computers, skew their sampling to catch errors that might significantly distort the financial statement. The actual transactions they check are relatively few.

HERE'S THE WAY an audit typically works. The accountants learn how a company's internal accounting system operates through flow charts and descriptions of the ways various transactions reach the income statement or balance sheet. In accounts payable, for example, these procedures would document what happens to goods as they come in from the supplier. The auditors test the system by checking a number of receipt slips against actual inventory to make sure that the items were received. Then they check the invoice against the client's canceled checks to be sure that the goods were paid for.

In the course of their work, auditors also evaluate business risks, even though the financial statement gives nary a hint of this. They examine the internal environment of a company—the quality of management and its manufacturing systems, for instance. Then they look at the external environment—the threat of foreign competition, the speed of technological change. They design an audit program with more checks if they judge that the company's internal accounting system is weak, and fewer if they think that it is solid.

What the auditor's report is *not*—and what many people misconstrue it to be—is a stamp of approval. Says J. Michael Cook, chairman of Deloitte & Touche: "There is a longstanding belief that auditors render a Good Housekeeping seal. We do not. We do not say this is a great investment to

THE BIG SIX



FIRM	1990 U.S. REVENUES in millions	PERCENTAGE OF REVENUES			COMMENTS
		Auditing	Management consulting	Tax	
Arthur Andersen & Co. SC	$2,282	35%	44%	21%	Includes world's largest consulting firm. Known for its staff training and technology. Many oil and gas clients.
Ernst & Young	$2,239	53%	22%	25%	Strong in health care and financial services, but bruised by S&L audits, including Lincoln Savings.
Deloitte & Touche	$1,921	57%	20%	23%	Kohlberg Kravis Roberts is a big client. Dominant in retail—Sears, R.H. Macy. Audits GM and Chrysler.
KPMG Peat Marwick	$1,827	53%	20%	27%	One of 1990's Malcolm Baldrige quality award semifinalists. Strong in banking and Silicon Valley.
Coopers & Lybrand	$1,400	56%	25%	19%	Sat out merger musical chairs. Dominant in telecommunications—clients are AT&T, BellSouth, Nynex.
Price Waterhouse	$1,200	48%	24%	28%	Oldest of the Big Six, and known for serving multinationals—IBM, Exxon, Kodak. Hurt by its BCCI work.

FORTUNE TABLE/SOURCE FOR REVENUE FIGURES: BOWMAN'S ACCOUNTING REPORT

DancingDramaComputersBalletSkiing
OperaArtRaftingCanoeingCycling
WE
DivingZoologyTravelLanguagesTheater
MakingMoviesSailingBaseballMake-Up
ArcheryActingInteriorDesignFashion
DONT
CarpentryFrenchCookingWeaving
Water-SkiingSnorkelingHorseback
RidingSurfingAstronomyCreativeWriting
INTERRUPT
ModelingAutoRepairPlumbingRunning
ABusinessMakingARecordBasketball
THE
PaintingPotteryGymnasticsMime
CareersCounselingKarateSoftball
SwimmingGolfRoller-SkatingIce-Skating
FUN
BowlingBadminton
DebatingSculpture
WITH
AmusementParksArcheologyJuggling
DressmakingRowingEcology
WhaleWatchingWhite-WaterRafting
COMMERCIAL
DancingDramaComputersBalletSkiing
OperaArtRaftingCanoeingCycling
DivingZoologyTravelLanguagesTheater
BREAKS.
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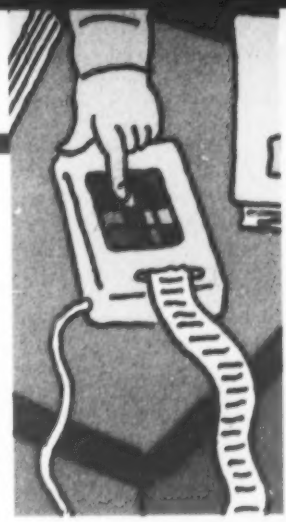
ArcheryActingInteriorDesignFashion
CarpentryFrenchCookingWeaving
THE GIRL SCOUTS
AS GREAT AS YOU WANT TO MAKE IT



"By the time financial statements are sent to the shareholders, they are not the relevant current information about the company."

make." An unqualified auditor's report is no assurance that management is not defrauding the shareholders.

Why is it that auditors often fail to detect fraud? The generally accepted standards do not require that they look for it, for one thing, and statistical sampling is unlikely to uncover it. Sampling is used to check areas where there are high-volume transactions. Most major cases of fraud occur outside a company's regular control system. BCCI, for example, kept a separate set of books through which many of its fraudulent loans were funneled.

But auditors are often too reluctant to rat on management even when fraud is staring them in the face. Instead they prefer to resign the account quietly. Though the client must file an 8-K form with the SEC whenever it parts ways with an auditor, the form can be worded to finesse the reasons for the disagreement, and the SEC would have no reason to look into it. Last year Representative Ron Wyden (D-Oregon) introduced a bill that called on auditors to report to the SEC if they discovered that a client was breaking the law and management or the board of directors did nothing to remedy the situation. But the bill failed to clear the Senate, and a revised version was introduced this summer.

PROBABLY the most compelling force keeping the auditors on their toes is the threat of lawsuits by shareholders or depositors in search of the deepest pockets to dip into after a business goes under. The partners are personally liable for damages, and James Emerson, publisher of *Professional Services Review* and a former Big Six accountant, estimates that the four largest firms each put a minimum of $3 billion at risk whenever they sign an opinion. Says he: "I don't care what the audit fee is. It would not justify cutting corners materially when you consider the liability."

Substantial investments in technology and training are helping the firms reduce the time and staff required for an audit, while keeping errors down. Peat Marwick, for instance, with only $1.8 billion in U.S. revenues, is one of Apple Computer's largest commercial customers. Computers are eliminating many of the tedious manual processes of transcribing numbers from source documents to work papers.

All the firms are promoting their expertise in client industries as a way of adding value to the audit. Says Peat Marwick's Madonna: "If people who understand the business are doing the work, odds are it will be done well." This year when Peat Marwick announced the election of 46 new partners, it listed them by their specific expertise (commercial banking, health care, insurance) in addition to the traditional functional breakdown (auditing, consulting, taxes).

The industry's continuing efforts to improve are making a favorable impression on corporate customers. In 1990 the Conference Board surveyed 375 chief internal auditors of mostly FORTUNE 500 companies and discovered that 46% rated their relationship with their auditing firm "very satisfactory," while 41% said they were "satisfied."

Less satisfied, shareholders and legislators are demanding more from the auditor, and the AICPA is responding. In a tardy move this summer to shore up the profession's reputation for independence, it prohibited most types of loans to its members from banks and S&Ls they are auditing. Until now the accountants had displayed a collective case of Sununuitis on the propriety of such loans, insisting that they did not compromise the borrowers' independence.

The GAO report on 11 failed thrifts criticized the audit guide for S&Ls issued by the AICPA as being badly out of date. The institute responded with the unusual step of publishing the report in its entirety in the March 1989 issue of the *Journal of Accountancy*, which goes to more than 300,000 members. By August 1990 the AICPA had drafted a new, much more

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comprehensive guide, which was published this fall. Says David Clark, the author of the GAO report: "The AICPA is taking great strides to ensure that its audit standards for S&Ls are strengthened. The new guide serves notice to the auditor that he or she has to be an expert in this business or has to get out of it."

Another AICPA measure that owes its existence to the S&L debacle is the rule, effective since 1989, that obliges auditors to evaluate the viability of every company they audit. If they have "substantial doubts" that the client can continue as a "going concern" for the next 12 months, they must say so unambiguously in the auditor's letter. The financial statements of more than 300 companies have been qualified on this count so far. They include Anchor Savings Bank, Eagle-Picher Industries, a diversified manufacturer, and Southland Corp., the owner of the 7-Eleven stores.

The institute is also discussing the relevance of the financial statement. A special committee that met for the first time this September is considering the need to allow more data about business risks and more forward-looking information, that is, forecasts that might include earnings projections, to appear in the annual report. Says Deloitte & Touche's Cook, a proponent of such changes: "By the time financial statements are sent to the shareholders, they are a stewardship document, not the relevant current information about the company."

RETHINKING the financial statement is long overdue. The disasters of the past decade argue strongly for a discussion of the risks and uncertainties a business faces. Auditors already evaluate these risks but under the current rules have no means to communicate their conclusions. Says Emerson: "Disclosure of business risk would also reduce the profession's liability exposure, not increase it."

Whether they want it or not, auditors are going to have to accept more responsibility for what they do even though they are doing it for less money. Class-action lawyers are waiting to pounce on the accountant who professes to be shocked when he discovers gambling at Rick's place and then does nothing about it. But if the obligations to report fraud and to assess the company's disclosure about the business risks it faces become the bulwark of the financial reporting system, audited financial statements will be not only trustworthy but valuable as well. F